B0650-2(u)

BANK OF AMERICA

Economic Outlook World 1983

Overview

January 1983

A slow and halting recovery from a prolonged recession is expected for the world economy in 1983. Real global economic growth will barely exceed 2 percent, making this one of the most hesitant recoveries on record. High unemployment levels and excess industrial capacity will continue to dampen world economic activity. While inflation continues to abate, many industries and countries are still burdened by heavy financial obligations acquired in previous years, making the financial environment rather fragile. (See Figure 1.)

The expected global recovery hinges upon economic progress in the United States, but the strength of the U.S. recovery is uncertain and depends on increased consumer spending for major durable goods and new homes. Demand for these items is strongly influenced by consumer confidence, which continues to be adversely affected by high unemployment. Most other sectors of the U.S. economy will be weak. Industrial capacity is significantly underutilized, and a revival of business fixed investment will be delayed. Government spending will be flat in real terms as modest growth in federal government expenditures is offset by declines in state and local spending.

Western Europe's recovery also will be sluggish and hesitant in 1983. Unemployment will continue to be high, but slower inflation and lower interest rates hold some promise for renewed long-term growth. Eastern Europe, where several nations face severe external debt problems, is in the midst of a serious downturn, and no improvement is expected in 1983.

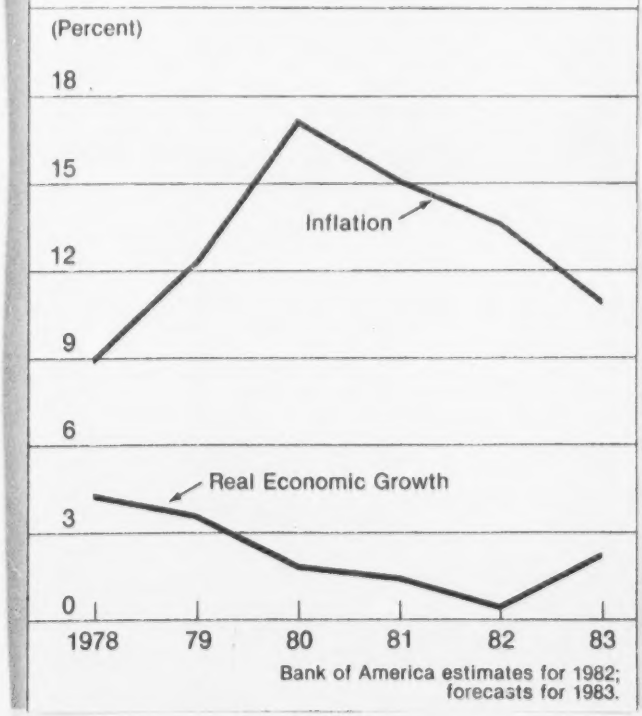
The gradual recovery in the industrialized nations will lead to modest increases in oil consumption. This will give some stimulus to economic growth in the Middle East. Most of the nations of Africa will continue to be afflicted by poverty, poor infrastructure, weak export markets, and declining foreign investment.

Asian economic recovery is contingent upon U.S. economic revival and access to major export markets. Large external debt burdens of many countries in Latin America will force them to focus on restructuring their output, spending, and foreign trade patterns. In both regions, much depends upon whether, and to what extent, trading nations take new protectionist actions.

Inflation is being reduced in most countries. Disinflation, restrictive monetary policies that dampen inflationary expectations, and reduced private credit demands are contributing to gradual declines in interest rates. These conditions will help eliminate inflation-induced distortions in financial markets and spending patterns. However, they also will force many firms and industries to make painful adjustments. In particular, firms and countries that have to service large short-term debts with depressed revenue streams will face a difficult year.

At the same time, severe pressure is being exerted on capital markets by the large public-sector deficits in many countries, despite strenuous government efforts to curb these deficits. An easing of monetary policies to encourage economic recovery is expected in 1983.

FIGURE 1 WORLD INFLATION AND REAL ECONOMIC GROWTH 1978-1983



Bank of America estimates for 1982; forecasts for 1983.

The World Economy

Factors Impeding Renewed Expansion

Although 1983 will see a slight cyclical upturn, vigorous expansion will not take place for many years—probably not within the decade—because the effects of a massive restructuring of the world economy have yet to be absorbed. There will be no early return to the economic vitality that lasted through most of the 1960s and was characterized by:

- Rapid economic growth—without excessive inflation in major industrial countries—underpinned by reconstruction efforts, technological progress, and a more liberal world trading and financial system.
- Increasing economic integration and cooperation, with continuing worldwide reductions in tariffs, progressive multilateral trade agreements, and rapid trade growth.
- An international monetary system based on fixed, but adjustable, exchange rates, with rapid international financial integration and strong public support for supranational lending institutions.
- Inexpensive energy resources.
- Relative social tranquility in industrialized nations, coupled with political stability in most regions of the world.

Table 1 World Economic Growth Rates 1981-1983

	GDP ($ Billions)	Real GDP (Percent Change)		
	1982	1981	1982	1983
World	$11,664	1.5	0.5	2.3
North America	3,313	2.1	-1.9	2.4
Western Europe	3,035	-0.2	0.7	1.5
Eastern Europe	1,603	1.1	1.6	1.8
Middle East	422	-2.2	3.2	4.2
Africa	388	3.4	2.6	3.3
Asia	2,087	3.8	2.6	3.6
Latin America	816	1.5	-0.5	1.3
OECD Members	7,648	1.4	-0.2	2.1
OPEC Members	668	0.2	3.0	4.0
Non-OPEC Developing Countries	1,526	3.1	1.2	2.8
Centrally Planned Economies	1,822	1.4	2.0	2.2

Bank of America estimates for 1982, forecasts for 1983.

In the 1970s, however, the fixed-rate monetary system fell apart, and two rounds of massive oil price increases ended the long era of cheap energy. The seeds of the current adjustment problems already had been sown by an unsustainable rate of worldwide economic expansion, by expectations of ever-rising living standards, and by government policies attempting to fulfill such expectations. These policies ultimately brought on global double-digit inflation.

In addition to high energy costs, the key factors that will prevent an early resumption of vigorous growth are the growing momentum of government spending and public deficits, changes in population structure and growing worldwide unemployment, underutilization of plant capacity, trade protectionism, and high external debts. All of these factors are closely interrelated.

Government Deficits

Governments are playing an increasing role as providers of social services and income support, as regulators of private economic activity, and as participants in the financial markets. Once implemented, government programs develop a momentum of their own. This tendency leads to accelerating government spending to fulfill rising public expectations, with commensurate increases in taxes or additional borrowings in the capital markets. Both tax increases and larger public borrowings discourage business expansion and force private borrowers out of the credit markets through unacceptably high interest costs. In turn, reduced business activity and investment produce less tax revenue for government programs, causing a greater need for public-sector borrowing and further pressure on interest rates.

Concurrently, as business activity slows, more people become unemployed and eligible for government transfer programs, which adds to the government deficit. The monetary authorities are then pressured to finance part of this deficit through new money creation, immediately raising inflationary expectations and interest rate premiums, and eventually raising the actual inflation rate. This is the vicious cycle that much of the world finds itself in today.

These dangers are being increasingly recognized by governments around the world, and efforts are under way to limit social spending obligations, in particular by trimming overly generous pension and welfare commitments.

Unemployment and Population

Unemployment in the industrialized world is exacerbated further by growing competition from the lower-wage, developing nations. As new technology is transferred to these countries, the problem will grow. Population dynamics also favor the developing world—both in age composition and in total numbers. Its working-age population has doubled in the past 25 years and is expected to double again over the next quarter-century. Meanwhile, the population in the industrialized nations is aging and remaining relatively constant in size. By the year 2000, only 12 percent of the world's inhabitants will live in these nations. The dynamic markets, therefore, will clearly lie in the growing Third World.

Protectionist sentiments will be strong in the West, motivated by desires to preserve existing jobs. At the same time, the growing population in the Third World will exert similar employment pressures, which may cause social unrest and migration to higher-income countries.

Idle Industrial Capacity

Underutilization of industrial capacity and low profit margins in the West will continue to discourage business investment and reduce tax revenues. The high external debt of the non-oil-producing developing countries will restrain their expansion. Further, their reliance on the International Monetary Fund (IMF) to support economic restructuring will strain the IMF's liquidity for years to come. The IMF will find it difficult to maintain its role as a short-term lender of last resort to countries with temporary payments difficulties while demands for long-term commitments will continue to grow.

Among the positive aspects of the global economic realignment now in progress are the expanding markets of the newly industrializing countries, continuing advances in technology, the growing awareness of the inflationary results of governmental activism, and the sharp drop in the inflation rates of the industrial countries in 1982-83. Growth for the next few years, however, will remain modest until the contours of the new economic order are clearer and the effects of disinflation have been fully digested.

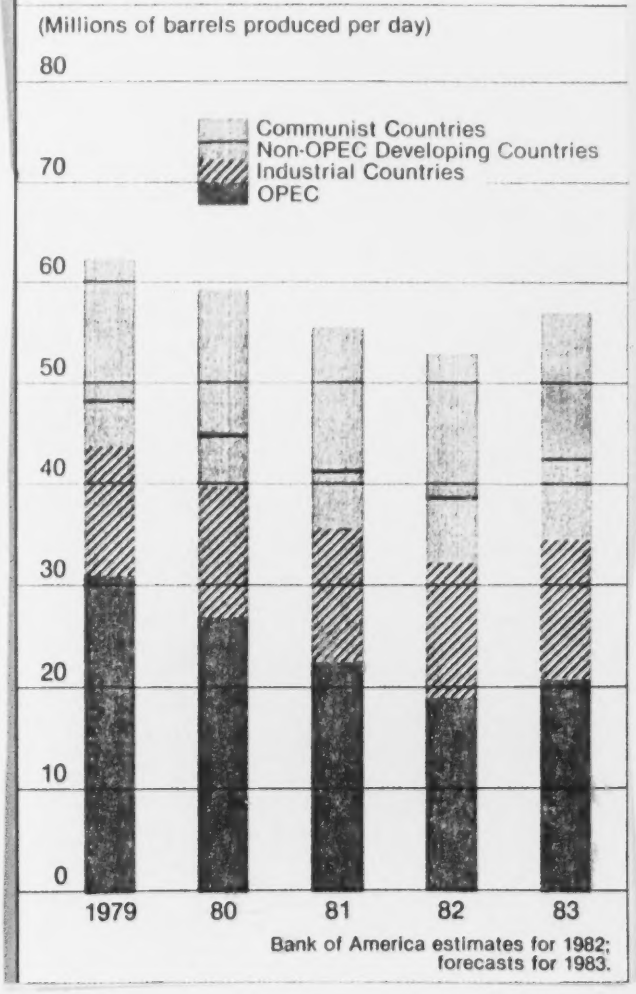
Commodities and Energy—Continuing Softness

For most international commodity markets, 1983 is likely to be a relatively calm year. Demand in all the major countries will remain weak, especially in the first half of the year. Generally, commodity prices will rise at rates lower than the rate of inflation, barring any major economic or political crisis involving key supplier countries.

Most agricultural commodity prices will decline in 1983 as bumper harvests in 1982 contributed further to the already abundant world stocks. The United States holds most of the world's exportable supplies of grains and oilseeds—now at excess levels—a situation exacerbated by the Soviet Union's reluctance to purchase U.S. grain. Also, the persistent strength of the U.S. dollar has counteracted the attractiveness of low U.S. grain prices. Under these conditions, agricultural prices are not expected to rise until late in the year.

The slow pickup in world economic activity will result in a gradual firming of demand for industrial commodities in 1983. Price increases will be limited by the expansion of productive capacity that has occurred in recent years. These increases will be led by precious metals and metals not burdened by excess capacity. Other metals—and forestry products—will command only very moderate price increases.

FIGURE 2 WORLD OIL PRODUCTION 1979-1983



The global crude-oil market is currently in an uneasy balance, with many producer countries eager to increase their exports. The output of the Organization of Petroleum Exporting Countries (OPEC) will increase slightly in 1983, reaching 21 million barrels per day (mb/d). Production in non-OPEC countries—particularly in the North Sea region, but also in Africa and Latin America—will continue to accelerate, reaching 21.5 mb/d. Including production in communist countries, world oil production will total 57 mb/d. (See Figure 2.)

Meanwhile, global oil consumption will grow by about 2 percent to 56.5 mb/d in 1983. This will be a reversal of the consumption decline of the past three years, reflecting a partial economic recovery and some resubstitution of oil for other energy sources. Also, two successive years of large inventory reductions will be followed by a partial replenishing of inventories. But the potential demand pressure from this source will be neutralized by the plans of OPEC producers to speed up production as market conditions allow. There is also a chance that continued divisiveness within OPEC might lead to a price war in 1983. If this should occur, the crude-oil price may fall considerably.

World Trade—Slow Progress

The volume of world trade will grow very little, if at all, in 1983 from its 1982 level. The projected dollar value of total goods and services trade will show a marked increase, but this figure incorporates both rising prices and allowances for a weaker U.S. dollar. The continued near-stagnation of world trade mirrors the slow economic recovery in major trading nations and weak demand throughout the world economy.

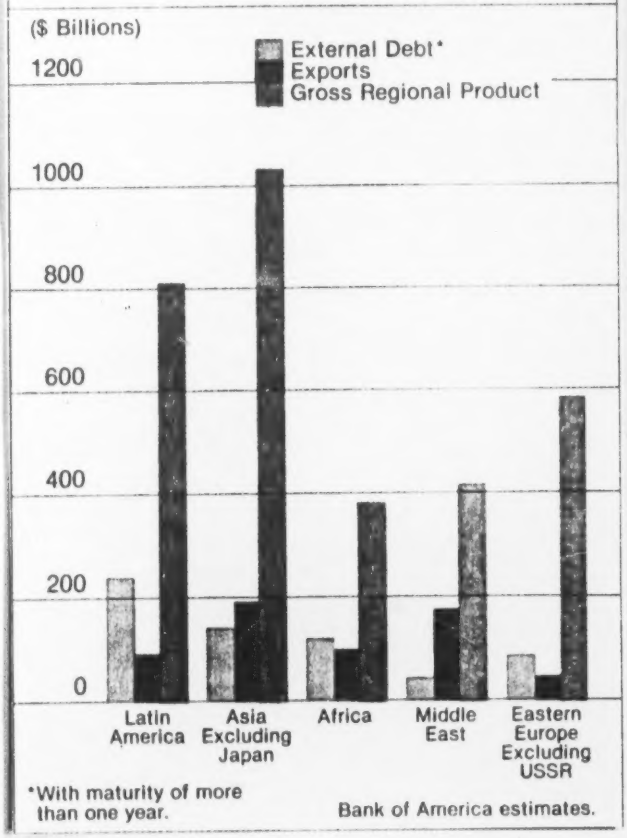
The slow growth of spending by both businesses and households in industrial countries is limiting the growth of their imports of capital, as well as consumer, goods. Government deficit spending primarily favors domestic products and does not directly generate much international trade.

A special complicating factor is the heavy international debt service payments of a number of semi-industrial and developing countries and the uncertain standing of these countries in private capital markets. They are under intense pressure to expand export earnings—in part, through more appropriate exchange rate policies—to be able to continue or resume their debt repayments. At the same time, difficulties in obtaining additional foreign credit will hamper their import capabilities.

Both Western Europe and Japan have expectations that the past undervaluation of their currencies against the U.S. dollar will finally give their exports a healthy boost. But all of the mature industrial countries will experience stiffer competition from the newly industrializing countries in Latin America and the Far East. This applies in particular to steel products, autos, appliances, and petrochemicals. The slow growth of oil export revenues will preclude any upsurge in import demand by OPEC countries.

Trade will, in some cases, be thwarted or retarded by government trade policies. For example, steel, autos, agricultural products, textiles, and synthetic fibers will remain subject to various trade restrictions. At present, there is a strong risk that major nations will erect new trade barriers, especially of the nontariff variety, to protect particular industries and to re-employ workers. The proposals for domestic-content requirements on the U.S. auto industry are a case in point. The General Agreement on Tariffs and Trade (GATT) has a critical role in trying to discourage a further proliferation of such trade restrictions, which could jeopardize the tenuous global economic recovery.

FIGURE 3 EXTERNAL DEBT, EXPORTS, AND OUTPUT FOR DEVELOPING REGIONS-1982



International Debt—Mounting Problems

Large international debts and heavy debt service requirements are placing severe burdens on a number of developing and newly industrialized countries. (See Figure 3.) Some have borrowed extensively in an effort to boost their productive capacity, while others have failed to adjust their production and expenditure patterns to the increased oil-import prices. Further, all of these nations are suffering from recession-reduced export demand.

The aggregate ratio of medium- and long-term debt service to exports for non-oil-producing developing countries is about 22 percent, up from 16 percent in 1980—a rough measure of their growing debt burden. But many countries also have incurred large short-term debts. Increased debt service obligations are lessening their ability to finance growing import needs and restricting opportunities for expanded domestic consumption and investment.

Further Debt Reschedulings

The list of countries engaged in reschedulings of their foreign debts continues to grow, and international banks are reluctant to make new commitments without clear evidence that the future debt service capacity of the borrowers is assured. In fact, with continuing weak export prices, the debt service burdens of many countries may actually become more severe than in earlier years. These countries will thus experience further difficulties in achieving the necessary adjustments in trade and domestic spending. Also, new external credit financing will not be as readily available as in the past.

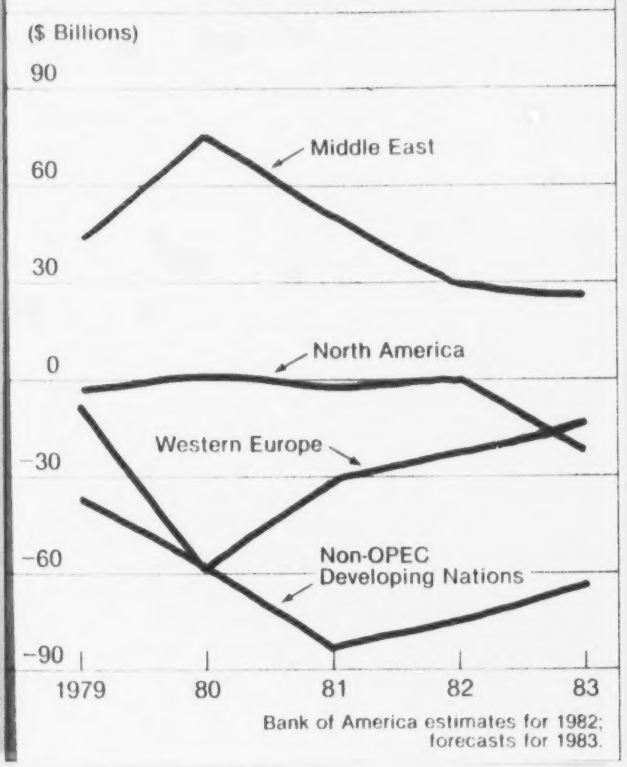
Current global debt relations should be viewed in the light of past and prospective current account positions. The 1983 current account picture is projected to be somewhat brighter for most regions than just after the 1979-80 oil price shock. (See Figure 4.) The improved global balance of payments equilibrium expected in 1983 is a sign that the global debt structure is no longer deteriorating as sharply as before. Rather, a process of pruning and consolidation has started. It is accompanied, however, by a slowdown in the growth of the Euromarkets. As the inflow of new petrocurrency deposits is tapering off, so is the availability of new Eurocredits to deficit countries. This is also reflected in a return to more appropriate risk premiums on international loans.

Role of the IMF

In this process of adjustment, the International Monetary Fund is acting as coordinator, adviser and, to a limited extent, lender of last resort. Almost all non-socialist countries with debt problems today have credit arrangements with the IMF, usually in the form of standby lines of credit that are periodically drawn upon. Its current resources may, however, soon be overtaxed, and there is a strong case for expanding the IMF's resources further, especially for emergency situations in which several large countries simultaneously face debt service difficulties. Basic agreement has already been reached on substantial increases in the quotas of the IMF members.

Equally important to the adjustment process are the economic policy recommendations that the IMF makes to countries seeking assistance. Its prodding helps countries with debt and payments problems find means to bring down inflation, scale back public spending, reduce exchange controls, and improve trade balances without resorting to drastic import barriers. Indirectly, IMF assistance also aims to prevent such countries from being cut off abruptly from the private international credit markets. To be sure, some of the policy measures might misfire, and there are risks of a political backlash in nations with strong opposition to the needed reforms. But the alternative —a breakdown of credit and trade relations with the industrial world—is decidedly worse.

FIGURE 4 SELECTED CURRENT ACCOUNT SURPLUSES AND DEFICITS 1979-1983



Bank of America estimates for 1982; forecasts for 1983.

Foreign Exchange—Mixed Currency Trends

Developments in foreign exchange markets in 1983 will be dominated by ongoing and anticipated changes in national inflation trends and current account positions. But political events could put additional pressure on currency relationships. On balance, the U.S. dollar is likely to lose some of its strength, at least against the Deutsche mark, the Swiss franc, and the Japanese yen. Against other leading currencies, the dollar is projected to retain or enhance its market value.

In terms of relative prices, the United States has lost about 25 percent of its international competitiveness because of the appreciation of the dollar over the past three years. Moreover, economic activity and aggregate demand are likely to recover sooner in the United States than abroad. These conditions will lead to a sharp increase in the U.S. trade and current account deficit in 1983. The resulting pressure on the dollar will tend to weaken its position vis-à-vis the currencies of the other low-inflation nations —West Germany, Switzerland, and Japan, in particular. The exchange rate adjustments could, however, be retarded by increased global political tensions, which traditionally increase the value of the dollar as a "haven" currency. Conversely, the adjustments could be accelerated by signs that the U.S. economy was rebounding more quickly than anticipated.

The sharp drop in the United Kingdom's inflation rate will help reverse the prolonged decline of British exports and should provide some support for the pound, yet sterling remains vulnerable to a drop in oil prices. Both France and Italy are experiencing much more rapid inflation than their major partners in the European Economic Community (EEC) and the European Monetary System (EMS). Official intervention in exchange markets will not long postpone a correction of the franc and lira parities vis-à-vis the rest of the EMS currency bloc. The Canadian dollar has little chance of recapturing any of the ground it has lost over the past couple of years, given Canada's unresolved economic policy problems and an unfavorable inflation differential against the United States.

Regional Analysis

Slow U.S. Recovery Begins

For the U.S. economy, 1983 will be a year of only modest progress. The nation's output is expected to grow at a rate of 1.3 to 2.5 percent, an uncharacteristically slow recovery following three years of virtually no growth. The strength and duration of the economic upturn will depend largely on how the Reagan Administration and the Congress resolve the federal budget controversy, as well as on the course of Federal Reserve money and credit policies.

Central to the 1983 forecast is a poor outlook for business fixed investment. The balance sheets of many firms remain weak because of high short-term debt service obligations and reduced cash flow. The rate of corporate bankruptcies is at its highest level in the post-World War II era. In addition, there is substantial excess capacity. Any increase in earnings, therefore, is likely to be used chiefly to strengthen corporate financial positions, rather than to expand capacity. Business fixed investment will continue to decline in real terms through much of the year.

Past and projected declines in mortgage interest rates will support a recovery in residential construction. Housing starts will rise to about 1.4 million units in 1983.

American consumers have retrenched financially by paying off debt at an unusually rapid rate, thereby putting the household sector in its strongest financial position in a decade. Meanwhile, stalled employment growth has slowed personal income growth, and fears of layoffs—underscored by a projected 1983 unemployment rate close to 10 percent—are eroding consumer confidence. However, the scheduled midyear personal income tax cut is designed to increase disposable personal income. As a result of these forces, real consumption is expected to rise by 2.5 to 2.9 percent in 1983. Together, household spending on consumer goods and housing will provide the main impetus to economic growth.

The U.S. trade balance will worsen sharply in 1983. The increased value of the dollar has lessened U.S. price competitiveness, and slow economic growth in key trading partners will weaken export demand. The merchandise trade balance will deteriorate from about a $36 billion deficit in 1982 to a $55 to $60 billion deficit in 1983. High interest earnings and service income from abroad will bring the 1983 U.S. current account deficit to a level of $15 to $20 billion.

Total government spending in real terms will be almost flat in 1983, as declines in state and local spending offset a modest increase in federal expenditures. Underlying these trends are anticipated substantial increases in defense spending and real reductions in federal nondefense spending. For the third consecutive year, real spending by states and localities will decrease—because of the combined effect of reduced federal grants, more conservative fiscal attitudes, and a weakened tax base.

Interest rates will trend downward over the year. Federal credit demands will remain large. But several factors are expected to offset the consequent upward pressure on interest rates. First, business credit demands will be weak. During 1981 and 1982, private credit demands were unusually high, primarily because business borrowing requirements were swollen by the need to finance capital expenditures and inventories while corporate profits and cash flow were declining. But as the economy gradually recovers, business profits and cash flow will increase. With the projected slow growth in fixed investment and a cautious inventory buildup, business credit needs will decrease through much of 1983.

Moreover, the personal savings rate is expected to remain relatively high, so that as incomes grow, the total supply of loanable funds will rise. Finally, the continued slowing of actual and expected inflation will decrease interest rate pressure by reducing the inflation premium.

The extent of the interest rate decline will reflect the strength of the overall recovery, for this will determine the growth of private credit demands. If the economy grows near the upper end of the 1.3 to 2.5 percent forecast range, interest rates will rise temporarily in the first half of the year and then resume a downward trend. If the economy is weaker, with real GNP growing near the lower limit of that range, private credit demands will be more moderate and interest rates will decline more sharply, with the prime rate ending the year in the 8 to 9 percent range.

The major domestic policy challenge now is to facilitate recovery without refueling inflation or overburdening the credit markets. The policies of the U.S. government, in cooperation with those of other leading nations, must encourage world trade and ensure global financial stability at the same time. The challenge is great and can be met only with the full cooperation of all parties.

For more detailed information on the U.S. economy, see Bank of America's Economic Outlook: United States 1983, *which may be obtained from the source listed on the back cover of this report.*

Table 2 Major Economies of North America

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent)		
	1982	1981	1982	1983	1981	1982	1983
Region	$3,313	2.1	-1.9	2.4	10.5	6.5	5.5
United States	3,021	2.0	-1.7	2.4	10.3	6.1	5.2
Canada	292	3.0	-4.2	2.8	12.4	10.7	8.5

Bank of America estimates for 1982; forecasts for 1983.

Canada—A Weak Turnaround

In 1983, the Canadian economy will make only a slow and partial comeback from 1982's contraction—the most severe in the industrial world. The main impetus for the projected growth in output will come from a modest revival of consumer spending.

Other elements of demand will remain weak. With recent low earnings and poor liquidity in the corporate sector, no strong rebound of business investment can be anticipated even though inventory liquidation has ended. The high unemployment rate will depress consumer confidence, and the slow recovery in the United States and other external markets will permit only a modest expansion of Canadian exports.

One positive development is the marked drop in the Canadian rate of inflation, projected at about 8 percent in 1983. This trend and the apparent easing of monetary policy in the United States will pave the way for a relaxation of money and credit constraints by the Bank of Canada. Some progress is likely to be made in reducing the federal budget deficit to more manageable levels. Against this background, the Canadian economy will be positioned to respond favorably to a future upswing in the world economy.

Western Europe—Slow Bottoming Out

Western European output will grow by an anemic 1.5 percent in 1983. Neither internal nor external forces will be strong enough to swiftly terminate the prolonged recession that began in 1980. However, there will be further progress in slowing inflation and restoring interest rates to more modest levels. These improvements will gradually pave the way for a more viable and competitive industrial structure and for more vigorous economic growth.

Historical business cycle records would suggest that a robust recovery is in the works. But present circumstances depart from the norm in several ways, and output is likely to grow by only 1 to 2 percent in 1983. Technological advances, competitive shifts in world markets, and new trade barriers in foreign markets have increased the extent of excess capacity in

Table 3 Major Economies of Western Europe

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent)		
	1982	1981	1982	1983	1981	1982	1983
Region	$3,035	-0.2	0.7	1.5	11.8	10.4	9.0
W. Germany	650	-0.3	-0.3	1.0	5.9	5.2	3.6
France	578	0.7	1.6	1.5	13.3	12.5	12.0
United Kingdom	470	-2.0	0.8	1.5	11.9	8.0	6.0
Italy	365	0.0	1.0	2.0	19.0	16.0	14.0
Switzerland	91	1.9	-0.5	1.0	6.5	4.9	3.5

Bank of America estimates for 1982; forecasts for 1983.

many traditional manufacturing sectors. Volatile capital flows are upsetting currency relationships and making investment planning difficult in industries that depend on foreign trade or foreign financing.

In addition, there is great uncertainty about the speed, breadth, and duration of the ongoing disinflationary process. This process is putting transitory pressures on the balance sheets of heavily indebted corporations and nations and is complicating credit pricing. Real interest rates probably will remain high—because of large public borrowing needs and lingering fears that inflation will accelerate again—thereby inhibiting the rate of business investment and credit-financed consumer spending.

Unemployment will remain stubbornly high in most European countries. Fiscal and monetary authorities, as a consequence, will be tempted to take abrupt reflationary steps. Still, most governments will try to avoid enlarging their deficits and will continue to try to curb money and credit growth. The average inflation rate is likely to drop below 10 percent—a rate that masks large country-to-country disparities.

The severe industrial slump of 1980-82 appears to have facilitated an overdue restructuring of British industry, and productivity is again on the rise. The Thatcher government's policies of monetary restraint have helped cut the inflation rate by two-thirds since 1980, and the fiscal deficit has now been brought under control. Even so, the 1983 growth rate will be modest unless world demand conditions strengthen or investor and consumer attitudes suddenly turn more optimistic. A potential drop in oil prices would pose an additional downside risk for the British economy.

The West German economy seems to be at a standstill; the hoped-for export revival has not yet taken place. The course of economic policy will be unclear until the next general election, scheduled for March, but efforts to reduce the public-sector deficit can be expected. German inflation is now one of the slowest in the region, and both nominal and real interest rates are headed downward. The combination of prolonged recession and approximate price stability suggests that the current account surplus will grow to about $5 billion while the Deutsche mark strengthens in the foreign exchange market.

Both France and Italy are still suffering from excessive rates of money and credit growth, accompanied by rapid inflation and external financial imbalances. Despite experiments with wage and price controls, France has lost some of its price competitiveness relative to major trading partners—including those in the European Economic Community—and its trade and payments deficits remain large. In Italy, the huge public-sector deficit is putting similar pressure on domestic prices and external accounts. As a result, the European Monetary System will be subject to continued uncertainties, and periodic realignments of currency relationships will be necessary.

The sluggish growth projected for these and other Western European economies in 1983 will be paralleled by a similarly slow growth of trade with other regions. However, if there is a broad-based turnaround in business confidence, the stage would be set for a more robust expansion of output and trade. The large pockets of underutilized resources would then permit a return to sustained growth without refueling the forces of inflation.

Eastern Europe—Economic Crisis Continues

The next two years will be the most difficult that the Eastern European economies have faced since World War II. They are in the midst of a serious downturn, accentuated by external debt problems, shortages of hard currencies, inefficient central economic planning, and, in some cases, political dissent. The medium-term outlook is clouded by the need to adjust to higher energy prices following the reduction of Soviet subsidies on energy trade.

The unfavorable economic prospects throughout the region reflect the fact that most of the nations

Table 4 Major Economies of Eastern Europe

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent)		
	1982	1981	1982	1983	1981	1982	1983
Region	$1,603	1.1	1.6	1.8	15.5	13.6	9.2
USSR	1,013	2.4	2.1	1.9	5.0	6.0	4.0
E. Germany	133	3.2	2.6	2.7	5.0	5.0	6.0
Poland	100	-13.0	-5.0	0.0	125.0	100.0	50.0
Yugoslavia	64	1.5	2.0	2.1	39.6	25.0	23.0

Bank of America estimates for 1982; forecasts for 1983.

are pursuing similar or coordinated economic policies. For example, current fiscal plans are extremely restrictive overall, calling for sharp limits on external borrowing and reduced imports from hard-currency areas. Shortages and rationing of both consumer goods and fuels reveal how pervasive are the problems of excess demand, low productivity, and sectoral imbalances. Price increases in 1983 will be very large in Poland and Yugoslavia, but will average only about 8 percent in the rest of the area. Hungary's economic prospects remain reasonably good as the country seems to have weathered its hard-currency crisis and planning is focusing increasingly on production efficiency.

The massive sums being spent on the Siberian-West European gas pipeline will stimulate the economies of Bulgaria, Hungary, and East Germany and will improve their foreign trade positions. When completed in the latter part of 1984, the pipeline also will generate additional Soviet export earnings. Meanwhile, most of the nations of the region are being drawn into closer trade relationships with the Soviet Union.

The combination of import restrictions and high external interest payments will keep the aggregate Eastern European current account deficit roughly unchanged from its 1982 level—about $10 billion. International credit access will probably improve as some successful paybacks are made and East-West tensions ease.

Apart from serious unrest in Poland and increasing partisan and labor dissension in Yugoslavia, the region as a whole will see little political turmoil. Increased government conservatism and stronger ties to the Soviets are keeping political criticism in check, and most of the population appears to accept current hardships with surprisingly little criticism.

The Middle East—Diverse Trends

Despite continuing political turmoil and soft oil markets, many Middle Eastern nations will record relatively good growth rates in 1983. The gradual recovery expected in the industrial nations will result in a minor increase in their oil consumption and oil imports from the Middle East. But continuing conflicts among the members of OPEC about their respective shares of the market will further weaken the global oil price structure. The performance of the non-OPEC Middle Eastern economies will be much less impressive.

The 1983 economic growth rate for the region is projected at 4 percent. This acceleration will be due primarily to a partial rebound of the Iranian economy, as well as renewed output expansion in Kuwait, Iraq, and the United Arab Emirates (UAE). Iran, after an output decline of more than 40 percent following the revolution, is expected to benefit from an aggressive oil-export policy and improved use of productive capacity. Kuwait, Iraq, and the UAE also will expand their oil exports from the depressed 1982 levels. Saudi Arabia's income growth will be limited to about 2 percent because of its efforts to support the crude-oil benchmark price by reducing its oil output. The economies of Israel, Turkey, and Pakistan, bolstered by foreign aid and aggressive export drives, will grow at an average rate of 4 to 6 percent.

Table 5 Major Economies of the Middle East

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent)		
	1982	1981	1982	1983	1981	1982	1983
Region	$422	-2.2	3.2	4.2	18.0	19.0	16.9
Saudi Arabia	151	8.1	6.0	2.0	8.3	10.0	10.0
Iran	85	-10.0	6.0	5.0	24.2	25.0	20.0
Iraq	40	-30.0	-5.0	8.0	9.0	9.0	8.0
Israel	19	4.2	4.0	3.5	116.8	130.0	120.0

Bank of America estimates for 1982; forecasts for 1983.

In many countries, the effects of massive investment programs in the late 1970s will be increasingly apparent. Large petrochemical plants and gas-gathering facilities will begin production and export in 1983. With much of the infrastructure in place, major construction activity is now slowing. Priority will be shifted to small-scale commercial, educational, and housing projects.

Middle Eastern fiscal and monetary policies will be profoundly affected by the changing oil-export picture and, in some countries, by prospective current account and budget deficits. The 1981-82 slowdown in oil exports has forced government agencies to scale back their expenditure programs for the second half of their 1981-85 national plans. In line with these conditions, money supply growth is expected to continue trending downward. Inflation in the region will therefore decelerate somewhat, especially in oil-based economies. While Israel will have little success in reducing its overall price increases below triple-digit rates, Turkey will manage to reduce its inflation to about 20 percent in 1983.

Trade growth will be sluggish, as slowly rising export earnings and cutbacks in government expenditures induce a similar slowdown in import expansion for oil-exporting nations. Other Middle Eastern countries will see an increase in their exports of agricultural commodities, and Israel will enlarge its capacity to export high-technology manufactures. The region's current account surplus will be about $27 billion, including substantial returns on oil-exporters' foreign financial assets.

Politically, the prospect for resolving the Arab-Israeli conflict has been enhanced by the Reagan Administration's peace initiative. Many Arab nations and the Palestine Liberation Organization have found positive elements in it. But more time and patience may be needed before direct and meaningful negotiations can take place. On the Iraqi-Iranian front, the deep-rooted animosity between the two nations and their rigid attitudes make the near-term chances for a peaceful settlement very slim. This ideological war poses insidious political and economic hazards to the whole Gulf region and endangers its role in the world economy.

Africa—Little Progress Expected

No general improvement can be discerned in the near-term economic outlook for Africa. The interrelated problems of poverty, poor infrastructure, and political strife are at present compounded by weak export markets and declining inflows of foreign investment and aid. In 1983, the overall rate of output growth will barely exceed the rate of population increase. In a small number of resource-rich countries, however, the outlook is somewhat more optimistic.

The recession in the industrial nations, coupled with higher energy prices since 1979, has led to an adverse shift in Africa's international terms of trade. Government policies also have often impeded economic growth. For instance, inappropriate trade and exchange rate policies shield low-productivity industries while retarding agricultural development. In addition, the public sector is absorbing too much of the limited administrative capacity of many African countries.

The agricultural sector should begin to gain as the trend toward rural migration to urban areas is reversed. New migration patterns will help improve the allocation of human resources and enhance the region's natural advantages.

Economic conditions and prospects on the African continent are becoming more differentiated. Countries of the Mediterranean region—Algeria, Egypt, Libya, Morocco, and Tunisia—will accelerate their growth in 1983. Positive growth rates also are projected for countries with abundant mineral resources and diversified exports—such as Botswana, Cameroon, Gabon, the Ivory Coast, Nigeria, and Zimbabwe. By contrast, the outlook for other African countries is generally dismal. The South African economy will fail to lift itself out of its deep recession unless gold prices rise sharply again or the frontier conflicts abate.

Africa's export earnings are expected to increase by a maximum of 10 percent in 1983. But this gain will be absorbed by larger payments for imported technology, food, and oil, and the combined current account will show a $25 to $30 billion deficit. Foreign exchange shortages will continue to limit severely the region's development prospects. The financial assistance and policy directions provided by the IMF will, however, be positive factors for these nations.

The political picture is clouded by several destabilizing conflicts: border disputes, secessionist efforts, and the struggle over apartheid in South Africa. Renewed negotiations regarding Namibian independence will be complicated by the question of a Cuban troop withdrawal from Angola. Despite a series of political coups in some of the poorest countries, the examples of Nigeria, Cameroon, and Senegal demonstrate that peaceful political succession is becoming possible in Africa.

Table 6 Major Economies of Africa

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent)		
	1982	1981	1982	1983	1981	1982	1983
Region	$388	3.4	2.6	3.3	16.5	17.2	14.9
Nigeria	73	6.0	4.5	5.0	15.0	16.0	15.0
South Africa	70	4.8	1.2	0.5	15.2	14.7	13.1
Algeria	44	2.9	5.0	6.0	14.1	12.0	10.0
Egypt	34	8.0	8.0	8.0	10.5	25.0	20.0
Sub-Sahara Africa*	109	0.2	0.7	1.4	19.5	17.8	15.0

*Excludes Nigeria and South Africa.

Bank of America estimates for 1982; forecasts for 1983.

Asia—Not Yet Back On Track

A slow economic recovery is projected for Asia in 1983. An aggregate real growth rate of about 3.5 percent is expected—low by traditional Asian standards, but well above the 1983 world average. Immediate growth prospects are adversely affected by continuing high global levels of long-term interest rates and by slow-growing import demand in industrial nations. However, inflation rates remain low, and when world economic activity strengthens, the countries of Asia will be able to capitalize on their firm base of human and natural resources, low labor costs, and general political stability. In addition, the ongoing changes in the Asian trade structure will help speed future economic growth.

Asia's performance will be altered considerably if recovery in the United States and Europe should be aborted, if current international protectionist pres-

Table 7 Major Economies of Asia

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent)		
	1982	1981	1982	1983	1981	1982	1983
Region	$2,087	3.8	2.6	3.6	7.3	5.0	5.7
Japan	1,052	3.0	2.3	3.0	4.9	2.9	3.4
China	254	3.0	4.0	4.5	2.6	2.5	2.5
India	169	4.7	0.6	3.7	13.0	9.5	9.5
Australia	164	4.3	0.9	3.0	9.6	11.0	11.5
So. Korea	73	8.0	4.0	5.5	24.0	7.0	14.0
Philippines	41	3.8	3.4	4.0	11.8	11.0	11.5

Bank of America estimates for 1982; forecasts for 1983.

sures intensify, or if the flow of oil from the Middle East were again to be interrupted.

The Japanese economy will recover partially in 1983 and achieve a real growth rate of 3 percent. No major stimulatory fiscal steps are anticipated. But as the Japanese-U.S. interest rate gap narrows, monetary policy is likely to ease slightly. The 1981-82 depreciation of the yen has given Japanese exporters a competitive advantage in international markets. As a result, the 1983 current account will improve substantially.

Global economic stagnation has retarded the growth of Asia's market-based developing economies across the board. In Hong Kong, Taiwan, and Korea, highly austere fiscal policies are nevertheless planned. Even with a potential pickup in demand for traditional exports, these countries will average only a 5 to 6 percent gain in output in 1983—a modest performance compared with the average annual growth over the past few decades.

Economic expansion in the ASEAN countries, including Indonesia, Malaysia, Thailand, and the Philippines, is largely tied to conditions in the markets for such primary commodities as rubber, tin, crude oil, and coconuts, which are currently depressed. While slower inflation will allow more expansionary monetary policies, reduced fiscal revenues are forcing most of the ASEAN governments to cut 1983's planned spending growth significantly. The overall economic growth rate for these countries is expected to be about 5 percent in 1983.

Supported by IMF assistance, India's economy is undergoing a structural adjustment and liberalization process. Barring a major drought, the economies of Australia and New Zealand will recover partially from their recently depressed levels because of rising export earnings and investment.

The aggregate current account deficit of Asia's developing countries is likely to widen. Most of these countries' debt service burdens will remain light compared with other developing regions, although some debt reschedulings may be necessary. The currencies of many of these developing countries will have to be devalued periodically, but the extent of such devaluations will be more moderate in 1983 than in recent years.

Latin America—Financial Problems Persist

The economies of Latin America are currently undergoing far-reaching and painful adjustments. Several major countries are trying to resolve their acute external liquidity crises by restructuring their debts, curbing the growth of domestic spending, and promoting export sector growth. Nearly all of them are trying to adapt to sluggish export markets while still reeling from the last round of increases in oil-import costs. Inflation remains out of control in several nations. Overall, the prospect is for little or no output growth in 1983. On a per capita basis, this means that Latin American real incomes will decline for the third consecutive year.

The most dramatic economic changes in the region are those concerning Mexico. Its immediate international financial problems have been alleviated through the package of credits recently obtained from international banks, foreign governments, and the IMF. But the necessary structural adjustments in spending levels, investment and employment patterns, and prices have not yet been implemented. Austerity measures will help rechannel resources into more productive, export-oriented activities; but in the meantime, output and employment levels will remain depressed.

In 1983, Mexico's output is projected to decline by 2 percent, a sharp setback for a country with rapid population growth and a decade-long record of swift output expansion. The peso depreciation that began in 1982 will translate into added domestic price pressures despite tighter fiscal and monetary policies. The inflation rate is expected to remain in the 60 to 80 percent range.

Despite its large foreign debt, Brazil is in somewhat more advantageous circumstances. Its overall

Table 8 Major Economies of Latin America

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent)		
	1982	1981	1982	1983	1981	1982	1983
Region	$816	1.5	-0.5	1.3	60.4	73.4	58.8
Brazil	292	-3.5	-2.0	1.5	105.5	105.0	75.0
Mexico	168	8.1	0.5	-2.0	27.9	65.0	75.0
Argentina	85	-3.5	-1.0	2.0	104.5	150.0	95.0
Venezuela	67	1.0	0.7	1.4	16.2	11.8	10.2
Chile	24	5.1	-12.0	2.5	19.7	21.0	30.0

Bank of America estimates for 1982; forecasts for 1983.

debt maturity is longer, and debt service obligations have so far been manageable. While inflation is rampant—with rates close to 100 percent per year—its effects on the economy are cushioned by wage and interest-rate indexation and successive minidevaluations of the cruzeiro. After two years of severe recession, only a mild recovery can be hoped for in 1983.

Argentina is suffering from a sharp economic slowdown, coupled with very rapid inflation and serious debt service difficulties. A partial recovery is anticipated in 1983 unless further political changes lead to drastic retrogressive economic policy shifts. In Chile, the modification of monetary controls and the 1982 currency devaluation may permit output to recover part of its steep 1982 loss. At the same time, those factors could produce new inflationary pressures. In Venezuela, declining petroleum revenues will reduce growth prospects and create a current account deterioration. In addition, an unfavorable exchange rate aggravates the capital flight problem.

Latin American exports in 1983 will grow by 12 percent in nominal terms, but show only a small volume increase. Although the region is still mainly an exporter of primary commodities, the export mix has tended to shift in favor of semi-industrial and manufactured goods. Latin America's debt service requirements, and fear that world demand may not increase much in the near future, are inducing policymakers to put greater emphasis on export diversification in the coming years.

Nominal import growth during 1983 will be limited to 6 percent—or close to zero in volume terms—since several nations have imposed drastic cutbacks on such expenditures. A regional trade surplus of nearly $11 billion is anticipated for 1983. The deficit in the services account will remain large, leading to a current account deficit of some $27 billion. The financing of such a large deficit will pose a significant challenge to the countries of the region.

Bank of America NT&SA, founded in 1904 by A. P. Giannini, has nearly 1,100 branches in California communities and 135 branches and representative offices overseas. As of September 30, 1982, BankAmerica Corporation's consolidated assets were more than $120 billion.

Prepared by the Economics-Policy Research Department of Bank of America using data available as of 12/28/82.
Additional copies of this report may be obtained by writing to Specialized Services #3401, Bank of America, Box 37000, San Francisco, CA 94137.